



THE CHAIRMAN

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

February 13, 2002

The Honorable John D. Dingell
Ranking Member
Committee on Energy and Commerce
U.S. House of Representatives
2322 Rayburn House Office Building
Washington, DC 20515

The Honorable Edward J. Markey
U.S. House of Representatives
2108 Rayburn House Office Building
Washington, DC 20515

Dear Congressmen Dingell and Markey:

Thank you for your January 30th letter in which you express concern about Section 125 of H.R. 3406, the "Electric Supply and Transmission Act." Section 125 would provide an exemption from the Investment Company Act of 1940 to certain affiliates of public utility holding companies if the provisions of H.R. 3406 that repeal the Public Utility Holding Company Act of 1935 are enacted into law. I very much appreciate, and share, your concern with this provision.

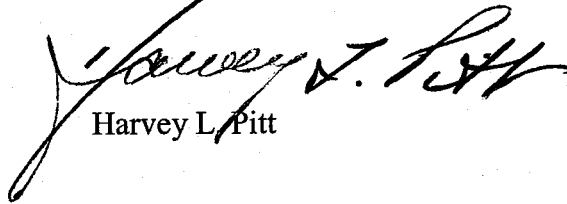
As you are aware, Commissioner Isaac Hunt testified before the House Energy and Commerce Committee, Energy and Air Quality Subcommittee on behalf of the Commission in December with respect to H.R. 3406. Although Commissioner Hunt indicated that the Commission supported the PUHCA repeal provisions of H.R. 3406, he also stated that the Commission opposes enactment of section 125. He noted that the Investment Company Act already provides the Commission with adequate authority to address status issues in a manner appropriate to each case and that we see no reason for legislation to deal with such issues. He further noted that we are prepared to work with any utility holding companies currently relying on the exemption from the definition of "investment company" provided by section 3(c)(8) of the Investment Company Act, if repeal of PUHCA leads to questions about their status under the Investment Company Act.

You also requested an analysis of various issues raised by section 125, information on public utility holding companies and their affiliates, the types of companies that might be able to rely on section 125 if enacted and information on the exemption granted to Enron in 1997 under the Investment Company Act. At my request, Paul Royce, Director of the Division of Investment Management, and his staff have prepared the enclosed memorandum that provides the analysis you requested and describes the materials that we are providing to you in response to your letter.

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The Honorable Edward J. Markey
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I hope that the Division's memorandum is helpful to you. As with other issues surrounding our position on PUHCA repeal, I would welcome the opportunity to meet with you at your convenience to discuss these matters. And, if you have additional questions or comments, please do not hesitate to contact me at 942-0100 or to contact Paul directly at 942-0720.

Yours truly,



Harvey L. Pitt

Enclosure

cc: The Honorable W. J. "Billy" Tauzin
The Honorable Joe Barton
The Honorable Rick Boucher

MEMORANDUM

February 13, 2002

To: Chairman Harvey L. Pitt

From: Paul F. Roye *BR*
Director, Division of Investment Management

Re: Letter from Congressmen Dingell and Markey dated January 30, 2002

This memorandum addresses issues raised by Congressmen John D. Dingell and Edward J. Markey in their letter to you dated January 30, 2002 concerning section 125 of H.R. 3406, the "Electric Supply and Transmission Act." Section 125 would exempt certain affiliates of public utility holding companies from the Investment Company Act of 1940 upon repeal of the Public Utility Holding Company Act of 1935 ("PUHCA").

On December 13, 2001, Commissioner Isaac Hunt, on behalf of the Commission, testified on H.R. 3406 before the Subcommittee on Energy and Air Quality of the Committee on Energy and Commerce of the United States House of Representatives. Although Commissioner Hunt testified in favor of the provisions of the bill that would repeal PUHCA, he also indicated that the Commission opposed enactment of section 125.

Congressmen Dingell and Markey have asked a number of important questions about the Commission's position on section 125. In order to assess the potential effect of section 125 if it were enacted, they have also asked for information on public utility holding companies and their affiliates and securities holdings. They also asked about the effect of, and information on, the exemption the Commission granted Enron from the Investment Company Act of 1940 in 1997. We have addressed their questions below.

I. Section 125 of H.R. 3406

Congressmen Dingell and Markey asked for information on the number of unregulated investment companies potentially created by section 125 and the types of securities in which those investment companies would be permitted to invest. As the information provided in the accompanying Forms U5S, and in some cases U-3A-2, indicates, there may be hundreds of unregulated investment companies that would result from enactment of section 125. It would be virtually impossible to determine an exact number of potential unregulated investment companies created by section 125.

We have also analyzed the types of securities in which those companies would be permitted to invest. Section 125(a)(2) would appear to allow a company that was a holding company affiliate on December 31, 2001 ("Company") to invest in any "investment securities" issued by any company engaged in the electric or gas utility

business or other permitted business activities¹ for a registered holding company ("Issuer"). This authorization is limited to the securities of Issuers the Company held on December 31, 2001 ("Qualified Issuer"). Section 125 would, however, permit the Company to acquire additional "investment securities" of the same type issued by the Qualified Issuer, as well as other types of "investment securities" issued by the same Qualified Issuer.² Therefore, although the universe of Issuers that a Company could invest in would be limited by the cut-off date of December 31 and the type of business in which an Issuer engages, the Company would be able to invest in and trade in all types of securities issued by Qualified Issuers.

Congressmen Dingell and Markey asked for our views on whether section 125 would affect the Commission's ability to regulate investment companies. Section 125 potentially could allow "grandfathered" companies to operate as unregulated investment companies. Under this provision, a "grandfathered" company that meets the definition of investment company under the Investment Company Act and in fact is in the business of investing, holding and trading in securities, would be allowed to operate outside the regulatory framework for, and SEC oversight of, investment companies. Although the types of securities in which a "grandfathered" company could invest would be limited by section 125, we nonetheless do not believe that there is any reason why investors in such a company should not be afforded the protections of the Investment Company Act. Moreover, as the SEC testified in December 2001, legislation is not necessary with respect to registered holding company affiliates if PUHCA is repealed. The SEC can administratively address any unique status issues faced by an operating company under the Investment Company Act.

II. Information about the Structure and Securities Holdings of Utility Holding Companies

In responding to Congressmen Dingell and Markey's letter of January 30, 2002, it is important to note that there are three types of holding companies that fall within PUHCA: registered holding companies; holding companies that are exempt from registration by rule; and holding companies that are exempt from registration by order.

We have provided a list of registered holding companies as of December 31, 2001. Registered holding companies file Forms U5B (registration statement) and/or U5S (annual report) which contain much of the information requested. Form U5B, a

¹ Although section 125 does not define "permitted business," it likely includes energy-related businesses permitted in PUHCA rule 58, ownership of exempt wholesale generators as permitted by section 32 of PUHCA, ownership of foreign utility companies as permitted by section 33 of PUHCA, ownership of exempt telecommunication companies as permitted by section 34 of PUHCA and any other type of activity in which the Commission has allowed registered holding companies to engage by order.

² Section 125(b)(3) defines "investment securities" by reference to section 3(a)(2) of the Investment Company Act. Section 3(a)(2), in turn, generally defines "investment securities" as all securities other than U.S. government securities and securities issued by majority-owned subsidiaries.

comprehensive form, is filed only once by each registered holding company. It is filed after the company files a notification of registration. Form U5S essentially updates the Form U5B. It is filed on May 1st of each year. Therefore, the latest U5S available is for the year ended December 31, 2000. Certain recently-formed registered holding companies have filed a U5B but will not file a U5S until May 2002.

Congressman Markey's staff asked us to provide information for exempt, as well as registered, holding companies. We have provided a list of holding companies exempt under sections 3(a)(1) and 3(a)(2) of PUHCA as of December 31, 2000.³ Companies exempt by rule file Form U-3A-2 (statement by holding company claiming exemption under rule 2). Companies exempt by order do not file Form U-3A-2, but like all public companies are required to file Form 10-K if they have public securities issued and outstanding. Together, Form U-3A-2 and Form 10-K provide much of the information requested for exempt holding companies. However, the Commission does not maintain forms for companies exempt by order that do not have public securities issued and outstanding.

While the questions contained in the letter refer to affiliates, most of the information required in Commission forms references holding companies or subsidiaries. Consequently, our responses reference holding companies and subsidiaries—not affiliates.

We have provided the following information responsive to questions 1 through 4 on page 3 of the request letter and noted the source of the information. Information that we are unable to provide is noted as well:

Question 1

- We have provided a list of thirty-five registered holding companies (twenty-seven top registered holding companies and eight subsidiary registered holding companies) as of December 31, 2001 and lists of subsidiaries that would appear on an organizational chart as of December 31, 2000 (Form U5B, item 4 and/or Form U5S, item 1). We are unable to provide lists of subsidiaries in organizational chart form because the information is not required in that format in Commission forms.
- We have provided a list of exempt holding companies as of December 31, 2000, lists of subsidiaries of companies exempt by rule (Form U-3A-2, item 1), and lists of subsidiaries of companies exempt by order that have public securities issued and outstanding (Form 10-K, exhibit 21).

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There are a small number of companies exempt by order under sections 3(a)(3), 3(a)(4) and 3(a)(5) of PUHCA. We are compiling information regarding these companies, and we will forward it as soon as it is available.

Question 2

- We have provided information for subsidiaries of registered holding companies that indicates whether they are wholly or partially controlled by the registered holding company (Form U5B, item 4 and/or U5S, item 1).
- We have provided information for subsidiaries of exempt holding companies that indicates whether they are wholly or partially controlled by the exempt holding company, for both companies exempt by rule (Form U-3A-2, items 1 and 2, where available) and companies exempt by order (Form 10-K, exhibit 21, where available⁴).
- We are unable to provide a list of all partially-controlled affiliates and a list of all other principal holders of equity or debt securities issued by the affiliates for registered holding companies and exempt holding companies because the information is not required in Commission forms.

Question 3

- We have provided for subsidiaries of registered holding companies, a list of directors and officers (D&O) (Form U5B, items 16 and/or Form U5S, item 6).
- We have provided lists of subsidiaries of registered holding companies (Form U5S, item 1). We have also provided subsidiary information for registered holding companies formed between 1999 through the present (Form U5B, item 4). The principal businesses of subsidiaries of registered holding companies are reflected in various filings made with the Commission. There is no one comprehensive form collecting the principal business information regarding subsidiaries of registered holding companies. Consequently, we have not been able to assemble this information within the time-frame set forth in the request letter. We will consult with Congressional staff regarding providing this information.
- We have provided for companies exempt by both order and rule, where that information is available in Commission forms, a list of D&Os of subsidiaries (Form 10-K, items 4 and 10⁵).
- We have provided a summary of the nature and form of subsidiaries of companies exempt by rule (Form U-3A-2, items 1 and 2). For companies exempt by order, item 1 and the notes to the financial statements of Form 10-K may contain business development information and segment information for the registrant and its subsidiaries.

⁴ This information is sometimes provided in Form 10-K but is not required.

⁵ Form 10-K contains lists of officers of registrants. In certain instances, proxy statements, which contain director information, are included as part of the 10-K filing, and have been included as part of our response.

Question 4

- We have provided for subsidiaries of registered holding companies, the following information: companies' securities held by registered holding companies and their subsidiaries, including the name of the issuer, the number of shares held and the book value (Form U5B, items 9 and 10 and/or Form U5S, items 1 and 5). We have not provided the market value of securities held because that information is not contained in Commission forms.
- We are unable to provide for each affiliate or subsidiary of each exempt holding company, a list of securities held by such companies (including all equity, debt, exempt or other securities of any type), including the name of the issuer of such shares, the number of shares held by the affiliate, and the market value of such shares because that information is not contained in Commission forms.

III. Exemption From The Investment Company Act of 1940

Congressmen Dingell and Markey asked about the impact of the exemption Enron was granted from the Investment Company Act of 1940. This exemption addressed Enron's participation in foreign infrastructure projects where Enron believed it could not acquire a majority interest for reasons such as restrictions imposed by local law. According to Enron's application for the 1997 SEC exemption ("Application"), Enron viewed many of its interests in foreign infrastructure projects as outside the definition of "investment security," but wanted the SEC exemption to eliminate any uncertainty. Enron further noted that the Investment Company Act was not intended to regulate industrial foreign infrastructure activity.⁶ Also, according to the Application, if the SEC did not grant the exemption, Enron would have structured or limited its participation in foreign infrastructure projects so as not to come under the definition of investment company in the Investment Company Act.⁷

Thus, it does not appear that Enron would have registered under the Investment Company Act absent the 1997 SEC exemption. An operating company typically finds the requirements of the Investment Company Act incompatible with its business needs. If Enron did register, the Investment Company Act would have significantly limited Enron's operations, including its ability to use leverage, engage in affiliated transactions,

⁶ In its June 17, 1996 report on the Securities Amendments of 1996 (the National Securities Markets Improvement Act of 1996), the House Committee on Commerce stated that it "expects the Commission to take administrative action expeditiously, either on a case-by-case basis through exemptive orders or through rulemaking, to exempt from regulation as investment companies U.S. companies that own substantial interests in foreign infrastructure companies and that are directly or through affiliates actively involved in foreign infrastructure projects."

⁷ The Investment Company Act defines an investment company, among other things, as any issuer that holds "investment securities" in excess of 40% of its total assets on an unconsolidated basis (exclusive of cash and U.S. government securities). To the extent Enron's non-majority interests in foreign infrastructure projects were "investment securities," these interests as well as any other "investment securities" held by Enron could have been limited to 40%.

and provide incentive compensation to employees. We have no basis for knowing what effect not granting the exception might have had on Enron's conduct.

We have provided documents responsive to Congressmen Dingell and Markey's request in question 7. These documents include the Order granting exemptive relief, the Notice relating to the Application for relief and the Commission's intent to issue an Order, the application for an exemption (including preliminary drafts of that application), comment letters from SEC staff to counsel for Enron, correspondence from counsel for Enron to SEC staff, and other materials. Consistent with our usual practice, we are not including internal memoranda, handwritten notes, and other non-public materials that reflect the SEC's deliberations. As always, we would be pleased to answer any further questions the Congressmen may have on this exemptive order, the documents produced, and the legal issues involved in granting the exemption. Any questions may be directed to me or David Smith of our office at 942-0720.